City of Cincinnati

BOARD OF TRUSTEES OF THE RETIREMENT SYSTEM

ROOM 240, CITY HALL
801 PLUM STREET
CINCINNATI OH 45202
PHONE 513-352-3227

Dear City of Cincinnati Retirement System Member:

This report has been prepared to keep you abreast of the challenges facing the Cincinnati Retirement System (CRS) and the steps taken to address these issues. Over the past year, the Retirement Board of Trustees has been examining various alternatives to resolve these issues and provide recommendations to the Mayor and City Council for action. As of this date, the Board has not adopted a plan to assure the solvency of the CRS, but a proposal and comments pending before the Board are provided as enclosures with this letter for your review and comment. If you have comments, please forward them no later than December 22, 2004 to: Cincinnati Retirement System, 801 Plum Street – Room 240, Cincinnati, Ohio 45202. You may also e-mail your comments to: retirement@cincinnati-oh.gov

Background

The City's retirement plan provides pension and health care benefits to approximately 10,000 active and retired members. Under the provisions of the plan an active member who meets the age and years of service requirements will be entitled to an annual pension at the rate of 2.50% or 2.22% (depending on the election of the member) for each year of service multiplied by the highest 3-year average of the member's pensionable salary. A member is eligible for a full pension at age 60 with 5 or more years of service or at any age with 30 or more years service.

Those active members who were hired on or before July 1, 1999 were given the option of choosing a retirement formula based upon either 2.50% of average highest compensation, excluding overtime pay, compensatory pay, and other lump sum distribution or 2.22% of average highest compensation, including overtime pay, compensatory pay, and other lump sum distributions. Once made, the choice was irrevocable. Persons hired after July 1, 1999 were placed in the 2.50% pension benefit formula (See CMC 203-1-A3).

For example, a member with 30 years of service with a highest 3-year average salary of $40,000 will receive an annual pension of $30,000 under the 2.5% formula alternative. For those who elected the 2.22% rate, overtime and lump sum payments for accrued vacation and sick time are included when determining the 3-year highest salary. In this case the pension may be higher or lower than $30,000 depending on individual circumstances. Each year, the retiree's pension benefit is increased by a 3% compounded cost of living adjustment.

In addition to the pension benefit, retired members also receive health care coverage under the plan. Medical, dental, vision, and prescription drug coverage are provided to all qualified retirees. The requirements to qualify for coverage have changed in recent years. Members who were hired prior to January 9, 1997 qualified for healthcare coverage with a minimum of 5 years of service. Members hired after January 9, 1997 must work a minimum of 15 years to qualify for healthcare coverage. Also, the members hired after January 9, 1997 will have their healthcare costs paid based on a points system explained below.

Under the current medical plan, retirees are offered either a PPO or an HMO plan. The following table outlines some of the provisions of each plan:

	PPO Plan	HMO Plan
Monthly premium share paid by retiree	None	$5.20 to $5.35 per person $10.90 for a family
Deductible	$50 single $150 family	None
Maximum out of pocket	$450 single $1,350 family	None
Prescriptions	$5 co-pay	$3 co-pay

A cost sharing provision has been instituted for more recent hires. Under this provision, those persons hired on and after January 9, 1997 and who retired with 15 or more years service would share in retiree health care costs based upon a formula defined under CMC 203-44. A "point system" based upon the sum a persons age at retirement and number of years of service at retirement was developed to define the costs shared by the retiree. The following table is the point system as defined in City Code:

If the sum of a members age at retirement plus his/her years of service is:

- 90 or more: the system would cover 100% of the cost of health insurance.
- 80 to 89: the system would cover 75% of the cost of health insurance.
- 70 to 79: the system would cover 50% of the cost of health insurance.
- 60 to 69: the system would cover 25% of the cost of health insurance.
- Less than 60: the system would cover 25% of the cost of health insurance.

As an example, a person who retires at age 53 with 30 years of service would have 83 points. The system would pay 75% of the cost of health care and the retiree would pay 25%. A minimum 15 years of service is required for retirees in this group. Therefore, the earliest a member could retire under this cost sharing provision in the year 2012.

Benefit Improvements

The retirement benefits outlined in the preceding section reflect a number of significant enhancements that were granted in the late 1990's. As a result of the extraordinary investment returns experienced during this time period, the Board in conjunction with the City's administration and City Council, implemented a number changes to the plan including:

1. Increasing the pension formula from 2.0% for each year of service to the current level of 2.50% or 2.22%.
   a. This change was made retroactive for all years of service accrued to date, resulting in an increase of up to 25% in a member's pension benefit.
2. The annual cost of living increase was changed from a simple COLA to a compounded COLA.
   a. The COLA is set a fixed 3% increase in a retiree's pension benefit, compounded annually.
3. Added vision and dental benefits for retirees.
   a. Provided at no cost to the retirees.

In addition, the employer contribution was reduced to 7% of payroll from the 14% to 20% contributed in earlier years.

According to the Mercer Human Resources Consulting, the plan's actuary, these benefit enhancements increased the plan's liabilities by approximately $236 million. The employer realized a $39 million savings due to the reduction in contributions to the plan (Attachment I - page 5 of Mercer's report to the Board dated October 3, 2002). These estimates are as of December 31, 2001 and would likely increase if updated using current health care inflation assumptions and employer payroll history.

Investment Performance

The financial solvency of the plan is largely dependent on how well the plan's investments perform. To maintain a healthy plan, the return on investments in the plan must average an assumed 8.75% per year. This assumption is approved by the Board. At the end of 1999, when the various benefit enhancements were being considered, the return averaged well above the required return of 8.75%. The following are the average annual investment returns for the portfolio as reported by Salomon Smith Barney, the plan's investment consultant, as of December 31, 1999:

	1 Year	3 Years	5 Years	7 Years
Total Return	11.89%	15.17%	18.34%	14.45%

With the extraordinary returns up to this time, the assets in the plan far exceeded the liabilities. At December 31, 1999, Mercer reported that the ratio of assets to liabilities (a measure of financial strength) was 161%, meaning that the plan held $1.61 in assets for each $1.00 of liability. At this time, the form of actuarial reporting used the Present Value of Accrued Benefits, an "accounting" measure, as the reported value of the system's accrued liabilities. This measure resulted in the highest ratio of the three generally accepted ratios. Under the other methods, the plan's funding ratios were 104% and 118% of the liabilities reported by the actuary in 1999.

Unfortunately, in March 2000 the equity market bubble burst causing the return on the plan's asset to fall. Even with the market recovery so far in 2004, average investment returns have not come back to the 8.75% return required to maintain long term solvency. The following table reports the plan's average annual returns as calculated by Salomon Smith Barney as of September 30, 2004:

	YTD	3 Years	5 Years	7 Years
Total Return	3.14%	5.44%	2.77%	4.31%

This has caused the plan's funding ratio to fall to an estimated level of between 90% and 94% at the end of the 3rd quarter in 2004. Although this ratio compares well to other pension plans, the goal is to have a 100% funding ratio for the CRS pension obligation.

Retiree Health Care Cost

At the same time as the equity market was reaching its peak, the Board began to recognize that retiree health care costs were increasing much faster than expected. This was reported in the May 2004 Retirement Report newsletter. In May 2001, Mercer reported that medical cost increased 14.3% during 2000, much higher than the 7% increase that was expected (Attachment II - page 2 of the Actuarial Valuation Report for 2000). The Board asked Mercer to conduct an experience study in order to assess the ongoing validity of future health care cost estimates as well as other factors used in determining plan liabilities. (Experience studies are common in pension plan management and are typically conducted every 5 years or so.)

In May 2002 Mercer reported its findings. Medical care cost inflation assumptions were increased from a 7% per year to 12% for 2002 trending down to 5.0% per year in 2016 and thereafter. Prescription drug cost assumptions were increased from a 7% per year increase to a 15% increase in 2002 trending down to 6.0% in the year 2020. (Mercer adjusted the trend rates in the December 31, 2003 to reach the 5% in 2012). Mercer also reported at this time that the actual increase in total health care cost in 2001 was between 35% and 40% from 2000. The net effect of the medical cost inflation assumption changes was an increase of $166,188,000 in plan liabilities. These additional liabilities were not expected and as such had not been paid for by the employees or employer.

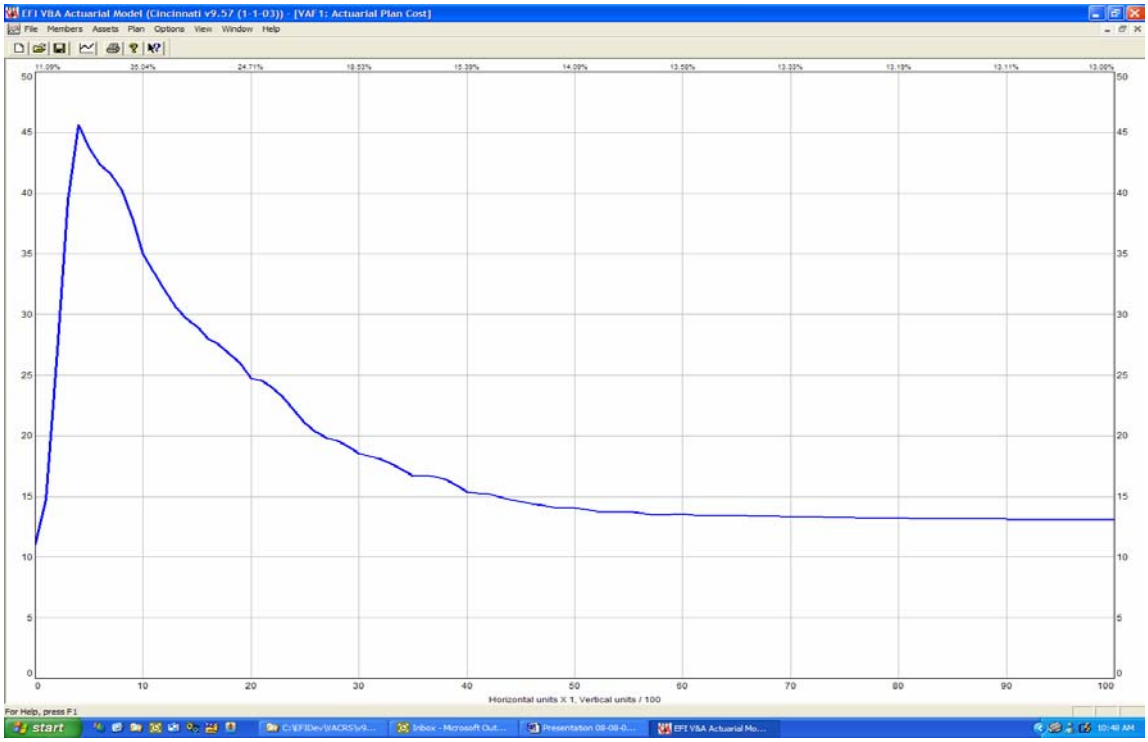
The Asset/Liability Study

In January 2003 the Board began work with the team of PCA and EFI (a pension consulting firm and an actuarial firm) that were hired to perform an asset/liability study for the plan. The goal of the study was to design an investment strategy for the plan that would, with a reasonable degree of certainty, assure the long-term solvency of the plan while stabilizing the cost paid by both the employees and the employer. The starting points for this study were a forecast of pension, health care, and plan administration payments that were expected to be made over the life of the plan. Mercer, using the revised health care cost inflation rates as discussed above, prepared the forecast, which was used in the PCA/EFI model.

PCA/EFI initial findings were presented to the Board during as offsite retreat on August 8, 2003. Most notable during this presentation was the consultants' discussions on the effect that the retirement of the baby boom generation would have on the plan. The Cincinnati plan is facing a surge in retirements, estimated at 850 or 23% of the currently active full time work force, over the next 4 to 5 years. This effect, though common among pension plans, will happen sooner and to a greater degree with Cincinnati's plan as compared to other plans in the country.

If it is assumed that no plan changes are made and that the employer funds all shortfalls in the plan, the increasing costs of health care, the bursting of the equity bubble, and the retirement of the baby boom generation will cause a four-fold increase the employer's contribution to the plan. According to PCA/EFI, if no change is made to the plan, the employer required contribution into the plan would increase to 46% of payroll in 2007. As an example of the shortfall impact, the City as employer will contribute about $19.8 million to the plan in 2004. Without plan changes, this amount would increase to about $83 million. This level of contribution would be impossible to make given the

City's financial condition. The current employer contribution rate is 11% of payroll. The following graph that depicts this problem was presented by the PCA/EFI to the Board.



Assuming the active members continue to contribute 7.0% of pay to the plan, the employer's contribution rate will remain above 20% for the next 25 years declining slowly back to the long term funding cost of approximately 13.5% of payroll in 60 years. All this assumes that the investments achieve the 8.75% return year in and year out, which will be a challenge to achieve. Sustained underperformance of the investment portfolio will cause the required contribution to increase from these levels. Absent any changes to the plan, the employer's contribution is scheduled to increase from approximately $19.8 million to be paid in 2004 to over $39 million in 2005 (Attachment III - page 9 of the Actuarial Valuation Report as of December 31, 2003).

In response to PCA/EFI's forecasts, the Board asked Mercer to evaluate the plan's pension and health care cost structure. A report was issued in September 2003, which quantified the costs paid by the system for healthcare, pension, and COLA benefits provided to retirees and their dependants. This report was presented to the Board and serves as the basis for various alternatives to be considered by the Board.

Summary of the Situation at the End of 2003

The justification for the benefit improvements and employer contribution reductions granted as a result of the equity market bubble of the late 1990's had been reversed by the market correction that began in early 2000. The over-funded status that the plan enjoyed in 1999 has turned to one that is under-funded at 94% as of the end of 2003.

The 1999 surplus was spent on improved benefits and reduced employer contributions with the belief that the remaining surplus in the plan was sufficient to safeguard the promises made under the plan. That has not held true. The plan had been hit by unexpected events, most notably the extraordinary increase in health care costs and dismal investment returns.

Essentially, those who retired before 2003 had paid into the plan based upon benefit assumptions that no longer existed, actively employed members were contributing to the system based upon forecasts that were no longer valid, and the City was contributing at a rate that is insufficient to maintain the long-term viability of the plan. Each of these three groups had benefited, albeit not in equal measure, from the decisions made in the late 1990's. Now with the realization of events unforeseen at the time, concessions are required from each benefited group.

Actions taken in 2004

On April 2, 2004, Mr. Daniel Radford, Chair of the Board of Trustees issued a letter (Attachment IV) to Mercer asking for the firm's help in

addressing the plan's funding problem. In this letter, Mr. Radford broadly framed the types of actions that the Board wanted Mercer to consider. This framework was devised with the intent to:

1. Maintain the pension or COLA benefits as they are currently provided under the plan by focusing any necessary changes on the plan's health care design; and;

2. To protect older, lower pensioned retirees who would be the most vulnerable to changes in the health care plan design.

In response to Mr. Radfords' request, Mercer conducted a series of presentations beginning with the May 2004 Board meeting. Three additional presentations were made at subsequent Board meetings. The additional presentations incorporated comments and suggestions made by the Board and by individual trustees during this time period.

At the October 2004 Board meeting, Mr. William E. Moller, Secretary of the Board of Trustees, distributed a proposal that called for the Board to support various actions as laid out by Mercer during their presentations since May. The proposal was not adopted, but was held in order to give the trustees time to consider it.

As of today, a total of seven alternative presentations have been made to the Board, each recommending specific actions to address the Board concerns as framed by Mr. Radford in his April 2, 2004 letter.

At the December Board meeting, alternatives were discussed by Board members but no action was taken. Mr. Radford and Board Member Ely Ryder provided written comments. In order to facilitate a timely resolution to the matter, Mr. Moller made the following motion:

I move that:

1. The Retirement Board accepts the proposal dated 9/30/04 to be circulated by the Board for comment;
2. I further move that the Board accept comments on the proposal for 30 days at which time the Board vote on the proposal or on a proposal as amended;
3. I further move that the Board vote on a proposal that fully funds the pension liability and funds the health care liability at 80%.
4. I further move that the sum of the employer contribution and the employee contribution to the fund is no less than that required to actuarially fund the plan.

The motion was seconded and unanimously approved by the Board.

In an effort to comply with the motion adopted by the Board, enclosed are Mr. Moller's proposal and written comments from Mr. Radford and Mr. Ryder. These have not yet been voted on by the Board and they are made available for your review and comment. Regarding the healthcare issue, please note that the assumed health care rates for AFSCME and non-represented management employees are attached for your information (Attachment V). Please forward your comments to the Cincinnati Retirement System, 801 Plum Street - Room 240, Cincinnati, Ohio 45202. You may also e-mail your comments to: retirement@cincinnati-oh.gov

Sincerely,

V. Daniel Radford
Chairman,
CRS Board of Trustees

William E. Moller
Secretary,
CRS Board of Trustees

Surplus Change (in millions)
December 31, 1997 to December 31, 2001

Surplus* December 31, 1997 (124% funded)		$425
Plan Changes		
Compound cola (retroactive) and survivor benefits	(122)	
Increase in pension multiplier	(73)	
Dental and Vision	(41)	
Total		(236)
Remaining surplus after plan changes		189
Gains/Losses/Assumption Changes		(14)
Asset Performance		(350)
Surplus December 31, 2001		$(175)

*Surplus = Market value of assets less present value of benefits

Note: Value of reduction in employer contribution 1998–2001 = $39 million

Highlights *(continued)*

Gain/Loss and Plan Change Information

The gain/loss analysis is done using the prior funding method which was in effect for 2000. The normal cost under that method increased from $(14,935,000) to $(7,790,000) due primarily to a higher than expected increase in medical costs and the addition of medical and dental benefits.

- *Return on invested plan assets*: The actual return on the actuarial value of assets in 2000 was exactly as expected. Since the expected value fell within the 90%-110% corridor around the actual market value of assets, there was no gain or loss.

- *Salary increases*: Overall, this year's salary increases for participants who were active last year and this year was less than expected. This generated a gain for the plan. The total present value of future normal costs decreased by about $11,847,000 as a result.

- *New Entrants*: Each year's valuation is based solely on the current participants of the plan, with no provision made for new participants in the future. As a result, every year the normal cost differs from the prior year since there are, in fact, new participants every year. This year, the new participants generated a loss (increase in present value of future normal costs) of approximately $6,985,000.

- *Demographic considerations*: The number of active participants decreased by 2.2% from 4,221 to 4,128, and the inactive membership increased by 0.8%. The net changes in status generated a gain (decrease in present value of future normal costs) of approximately $6,270,000 for the year.

- *Post-retirement medical benefits*: Medical claims for the 2000 calendar year increased by 14.3% from 1999 – significantly more than the 7.0% increase assumed. As a result, a loss (increase in present value of future normal costs) of approximately $41,517,000 was generated for the year.

- *Plan Benefits*: Dental and vision benefits were added to the plan and included in this year's valuation. The increase in the present value of future normal costs is approximately $41,021,000.

SUMMARY OF VALUATION BENEFITS

The summary presented on the following page provides a comparison of the principal valuation results for each of the last five plan years. Its purpose is to provide the Board with a concise summary of past plan operations which – when combined with estimates regarding future economic, legislative, and financial factors affecting the plan – can give insight into anticipated future contribution requirements under the plan.

Section 1.3

Determination of Contribution

	December 31, 2003	December 31, 2002
1. Present Value of Projected Benefits:		
(a.) Active Participants	$ 1,079,203,473	$ 1,080,210,906
(b.) Participants with Deferred Benefits	38,577,073	22,234,833
(c.) Participants Receiving Benefits	1,497,450,197	1,439,727,179
(d.) Total	2,615,230,743	2,542,172,918
2. Present Value of Future Employee Contributions	90,861,942	92,470,759
3. Present Value of Future Normal Costs	$ 104,865,627	$ 105,953,792
4. Entry Age Accrued Liability (1)(d)– (2)–(3)	2,419,503,174	2,343,748,367
5. Actuarial Value of Assets	2,279,721,027	2,371,350,218
6. Unfunded/(Surplus) (4) – (5)	139,782,147	(27,601,851)
7. Amortization of Unfunded/(Surplus) Over 15 Years (at the beginning of the year)	15,711,360	(3,102,418)
8. Amortization of Unfunded/(Surplus) Over 15 Years (assuming monthly payments)	16,437,225	(3,245,750)
9. Total Normal Cost, including Expenses (at the beginning of the year)	34,825,330	34,350,195
10. Total Normal Cost, including Expenses (assuming monthly payments)	$ 36,048,212	$ 35,937,174
11. Employees' Expected Contributions to Normal Cost (assuming monthly payments)	12,675,012	12,886,795
12. Employer Normal Cost (10) – (11)	23,373,200	23,050,379
13. Employer Total Cost (8) + (12)	39,810,425	19,804,629

Attachment IV

City of Cincinnati

BOARD OF TRUSTEES OF THE RETIREMENT SYSTEM

ROOM 240, CITY HALL
801 PLUM STREET
CINCINNATI OH 45202
PHONE 513-352-3227

April 2, 2004

Mr. Gary Dickson
Mercer Human Resources, Inc.
312 Vine Street, Suite 2500
Cincinnati, OH 45202

Dear Gary,

As you know, the City of Cincinnati Retirement System is completing an asset/liability study that may result in changes to the System's investment strategy. As the Board has moved through this process, it has become apparent that the growth in the System's future liabilities and the resulting contribution that will be required to maintain the financial health of the plan will approach levels that are unsustainable. In order to ensure the continued financial health of the System, the Retirement Board of Trustees and the City Administration have agreed that we must explore alternatives to the current plan structure and funding methods. To this end, I am asking that you prepare a set of alternatives for presentation to the Board at its May 6th meeting that will address the retirement system's financial health.

To help guide your thought process, here are a few items that the Board may consider.

1. An assumed rate of return no lower than 8.25% and no higher than 8.75%.
2. Preservation of pension benefits for current and future retirees.
3. Flexibility in the funding level for medical benefits, but assumed funding of no less than 85%, and the transfer of some assets from pension to medical (if such action complies with IRS regulations).
4. Health care cost sharing by retirees, equivalent with active city employees.
5. Health care cost sharing should not adversely affect older retirees with relatively small pensions.
6. Recognize accrued gain and losses as of 12/31/03.
7. Increase in employee and employer contribution (employer contribution increased to 11% in 2004).

It is my hope that you can add substance to these issues. I would ask that you present specific recommendations along with the cost and funding effect of each recommendation after your presentation of the 2003 actuarial valuation results at the May meeting.

If there are other items that you think would be helpful, please let me know. Please contact me at 421-1846 if you have any questions. I look forward to hearing your thoughts on this matter.

Sincerely,

V. Daniel Radford

Chairman

City of Cincinnati Retirement Board of Trustees

Attachment V

2005 HEALTH PLAN

ANTHEM BLUE ACCESS PLAN - 80/20

		SINGLE	FAMILY
PREMIUM SHARE (monthly)		$12.66	$34.98
DEDUCTABLE	NETWORK	$300	$600
	NON-NETWORK	$600	$1,200
COINSURANCE	NETWORK	20% to $1,200	20% to $2,400
	NON-NETWORK	50% to $2,400	50% to $4,800
OUT-OF-POCKET	NETWORK	$1,500	$3,000
	NON-NETWORK	$3,000	$6,000
RX (generic/brand/non-formulary)		$10/$20/$30	$10/$20/$30
RX (mail order)		90 DAY SUPPLY FOR TWO COPAYS	

City of Cincinnati

Interdepartment
Correspondence Sheet

Date: September 30, 2004

To: Cincinnati Retirement System (CRS) Board

From: William E. Moller, Secretary, CRS Board

Copies: Bruce Fink, Pension Manager

Subject: Proposal to Meet Pension Obligations

As promised, I am submitting a motion for the Board to consider at the October 7, 2004 meeting to address the ability of the CRS to meet its obligations to current and future retirees. My purposes for submitting the motion are fourfold:

- First, the motion provides a balanced set of plan changes with regard to asset valuation, employer and employee contributions, health care cost sharing, plan funding level, investment return, and investment risk mitigation;
- Second, the plan changes in the motion have an actuarial basis because they are among the options evaluated by Mercer;
- Third, the motion provides a focus for discussion for the Board;
- Fourth, the motion is presented now so that the Board can make a recommendation to the Mayor and City Council in the context of the budget that will be submitted by the City Manager in early November 2004.

I know that not all Board Members will like all of the proposed plan changes, but I ask that they be viewed as a holistic solution to the funding challenge that we face. The motion should also be viewed in light of the City's financial strain that is likely to continue. Please take note that CRS is not unique and other retirement systems have made or will make even more drastic changes.

I remind the Board of its fiduciary responsibility to act in the best interest of CRS and of the City's obligation to keep the promise to retiree and active members that retirement benefits will be there when needed. If we do not make plan changes such as those in the motion now, abrupt and more painful changes will have to be made in the future. The longer we wait, the more difficult our task will be.

Should the Board approve these changes, I recommend that the Board complete the Asset/Liability Study to determine the CRS investment mix and investment return benchmark.

I encourage and welcome your comments and suggestions regarding the motion.

I move that the City of Cincinnati Retirement Board of Trustees instruct Mercer, the system's actuary, to formally incorporate the following assumptions and plan design amendments into annual actuarial valuations. These changes shall be incorporated in the 2003 Actuarial Valuation Report and the 2003 Management Report and in each year's reports thereafter. This motion is provided to both solve the CRS funding problem and to focus the Board on a solution.

1. Restate the actuarial value of the systems assets to their market value as of December 31, 2003. Thereafter, continue the asset value smoothing method currently in place.

2. Retirees will continue to be offered health care coverage in the networks and under the plans that are offered to the active AFSCME and active management employees as provided from time to time by the City through Anthem.

   Within these networks and plans though, the plan terms, i.e. co-pays, maximum out of pocket, office visit costs, prescription co-pays, etc. shall be as follows:

   a. For those retirees who were awarded:
      i. A disability retirement or,
      ii. A service retirement that was not calculated under the 2.22%/2.50% multiplier option and who were age 65 or older as of December 31, 2003 or,
      iii. A service retirement that was not calculated under the 2.22%/2.50% multiplier option, upon reaching age 65,

      Coverage shall continue (or in the case of 2(a)(iii) be re-established as of the next open enrollment) under the plan terms, i.e. co-pays, maximum out of pocket, office visit costs, prescription co-pays, etc. as is currently offered retirees under the Anthem HMO and PPO plans.

   b. For those retired members not included in 2(a), the plan terms, i.e. co-pays, maximum out of pocket, office visit costs, prescription co-pays, etc., offered through Anthem's network shall be set at the average of that offered to the active AFSCME and the active management employee under each the PPO and the HMO plan.

   c. The health care plans offered retirees under 2(b) shall be adjusted as the active AFSCME or active management plan terms may change from time to time.

3. Adopt a premium share schedule for the retirees defined in 2(b) equal to the average, by plan type, of that paid by active AFSCME and active management employees as such may change from time to time.

4. Reduce the funding target for health care liabilities to 80% from 100%.

5. Reduce the assumed rate of return from 8.75% including expenses to 8.25% including expenses.

   a. Adopt, as a guiding principle, that the Board shall continue to use any surplus that might accumulate in the fund, as a result of the actual return on the investment portfolio exceeding the assumed rate of return, to affect further reductions in the actuarial return assumption.

6. Assume a $2 MM annual reduction in investment management and other system expenses. This could be achieved by increasing the allocation to passively managed investments to approximately 40% from the current 8% allocation.

7. Increase the employee contribution rate to 8.50% of pensionable salary.

8. Recognize and maintain the recently increased employer contributions at 11% of pensionable salary.

Mercer has provided a preliminary analysis of the effect these changes will have on the plan's liabilities, normal cost and contribution requirements as of December 31, 2003.

Cincinnati Retirement System - Comparison of Alternative Plan Designs

	Current Plan	"Average" AFSCME/Mgmt Plan
Normal Cost	$37.2M	$33.4M
(% if pay)	21.5%	19.3%
Total Contribution	$68.3M	$34.4M
(% if pay)	39.4%	19.9%
Pension Accrued Liability	$1,721M	$1,721M
Medical Accrued Liability	$831M	$568M

Notes:

Results based on 8.25% assumed investment return

Assumes expense load on Normal Cost is reduced from $8M to $6M due to passive investment change

Assets set to Market Value at 12/31/2003

Medicare Part D reflected

Plan designs:

- Premium share implemented
- Medical plan changed to "Average" of Management and AFSCME plans
- Protected retiree group remain in current medical plan (all pre-1998 retirees for post-65 coverage)

80% Medical Funding Normal Cost is based on 100% pension normal cost plus 80% of medical normal cost

80% Medical Funding Total Contribution allows medical surplus to offset pension underfunding

Calculations based on data, assumptions, and methods used in the 12/31/2003 valuation except as noted.

Furthermore, I move:

9. To direct staff to work with the City Solicitor to draft changes to the City's Municipal Code to embody the changes proposed.

10. To direct staff to develop the specific health care plan terms (i.e. co-pays, maximum out of pocket expenses, etc.) that will be offered. The plan design(s) proposed by staff shall be in accordance with this motion and shall be evaluated by Mercer in order to assure that the cost to the system is expected to be no greater than that assumed in the 2003 actuarial valuation.

11. That the new plan design for the affected retirees shall become effective no later than January 1, 2005.

12. That the health care plan design and premium share schedule shall be re-evaluated, as outlined above, in conjunction with every second actuarial valuation, beginning with the valuation for the year ending December 31, 2004.

By:

_____

William E. Moller
Secretary

Comments from V. Daniel Radford on Bill Moller's proposal:

MOTION

I move that the City of Cincinnati Retirement Board of Trustees instruct Mercer, the system's actuary, to formally incorporate the following assumptions and plan design amendments into annual actuarial valuations. These changes shall be incorporated in the 2003 Actuarial Valuation Report and the 2003 Management Report and in each year's reports thereafter.

Plan Changes

1. Restate the actuarial value of the systems assets to their market value as of December 31, 2003. Thereafter, continue the asset value smoothing method currently in place.

2. Retirees will be provided health care coverage in the networks and under the plans and terms that are offered to the active AFSCME and active management employees, with minor modifications to the out-of-pocket maximum and two year premium phase-in (I suggest half of the employee premium share at a time). Prescription co-pays will count toward the out-of-pocket maximum. This is consistent with the Cincinnati Municipal Code, which states that retiree health care is of the type and extent that is provided to city employees (CMC 203-43, 203-44)

   Within these networks and plans, the terms (i.e. premium share, co-pays, maximum out of pocket, office visit costs, prescription co-pays, etc.) shall be as follows:

   a. For those retirees who were awarded:
      i. A disability retirement or,
      ii. A service retirement that was not calculated under the 2.22%/2.50% multiplier option and who were age 65 or older as of December 31, 2003 or,
      iii. A service retirement that was not calculated under the 2.22%/2.50% multiplier option, upon reaching age 65

      coverage shall continue (or in the case of 2(a)(iii) be re-established as of the next open enrollment) under the same terms (i.e. premium share, co-pays, maximum out of pocket, office visit costs, prescription co-pays, etc.) as are currently offered retirees under the current Anthem HMO and PPO plans.

   b. For those retired members not included in 2(a), the plan terms (i.e. premium share, co-pays, maximum out of pocket, office visit costs, prescription co-pays, etc.), offered through Anthem's network shall be set at the average of

that offered to the active AFSCME and the active management employees under each of the current plans.

c. The health care plans offered retirees under 2(b) shall be adjusted as the active AFSCME or active management plan and terms may change from time to time by the City through Anthem.

3. Reduce the funding target for health care liabilities to 80% from 100%. The medical surplus shall reduce the medical portion of the contribution but not less than zero. The pension contribution shall be the total contribution less the medical contribution.

Comment: If these recommendations are accepted, this may be required to be lower.

4. Reduce the assumed rate from 8.75% including expenses to 8.25% including expenses.

   a. The Board shall continue to use any surplus that might accumulate in the fund, as a result of the actual return on the investment portfolio exceeding the assumed rate of return, to affect further reductions in the actuarial return to mitigate investment risk by enabling the Board to take a more conservative investment approach.

5. Assume a $2 MM annual reduction in investment management and other system expenses. This could be achieved by increasing the allocation to passively managed investments to approximately 40% from the current 8% allocation.

Comment: It's not realistic to assume a $2 MM savings by replacing 32% of actively managed investments with passively managed investments. Investments decisions should take several factors into account, not just management fees. The proposal does not take into consideration instances in which actively managed investments outperform passively managed investments. The fund may save money on fees, but lose money on returns. The principal focus should be on risk adjusted returns versus an appropriate "index" benchmark…net of all fees. It may be appropriate to request a 15% fee reduction across the board for a three year period during the transition, which would result in a net savings of $1MM.

6. A disagreement has arisen between the City and the Union (AFSCME) about whether changing the employee contribution above 7% must be bargained. The Retirement Board should not get involved in labor-management disputes, and these issues are for the City and the Union to resolve. It is my opinion that it is necessary to increase the payroll contribution by 1.5% in order for the Retirement System to remain solvent, however, until the City and the Union determine whether this issue should be bargained the Retirement Board should offer no recommendation on how or when to increase contributions. One avenue the parties might consider is to settle the issue without prejudice, thereby leaving the matter up for discussion at some future point. In other words, agreeing on a course of action for now, while allowing the possibility of revisiting it in the future. This suggestion should not be construed as a recommendation, but simply as something the City and the Union might consider to resolve this issue.

Comment: The OPERS rate is about to increase to 10%, so this statement will be inaccurate.

7. Recognize and maintain the recently increased employer contributions at 11% of pensionable salary for 2005 and 2006.

Deleted: Increase the employee contribution rate to 8.50% of pensionable salary.

Deleted: This is consistent with the current OPERS rate.

Mercer has provided an analysis that includes the effect of these changes on the plan's liabilities; normal cost, and contribution requirements as of December 31, 2003.

Change Comparison
Cincinnati Retirement System – Comparison of Alternative Plan Changes

	Current Plan	Proposed Changes AFSCME/Mgmt Plan
Normal Cost	$37.2M	$33.4M*
(% of pay)	21.5%	19.3%*
Total Contribution	$68.3M	$34.4M*
(% of pay)	39.4%	19.9%*
Pension Accrued Liability	$1,721M	$1,721M*
Medical Accrued Liability	$831M	$568M

Comment: *If recommendations are accepted, these figures will need to be adjusted.

Notes:
Results based on 8.25% assumed investment return
Assumes expense load on Normal Cost is reduced from $8M to $6M due to passive investment change

Comment: See comment on Item # 5.

Assets set to Market Value at 12/31/2003
Medical Part D reflected
Health Care Plan design changes:
- Premium share implemented
- Medical plan changed to "Average" of Management and AFSCME plans
- Protected retiree group remain in current medical plan (all pre-1998 retirees for post-65 coverage)

80% Medical Funding Normal Cost is based on 100% pension normal cost plus 80% of medical normal cost
80% Medical Funding Total Contribution allows medical surplus to offset pension under funding
Calculations based on data, assumptions, and methods used in the 12/31/2003 valuation except as noted.

Additional Elements

Furthermore, I move:

8. To direct staff to work with the City Solicitor to draft changes to the City's Municipal Code to embody the changes proposed.

9. To direct staff to develop the specific health care plan terms (i.e. co-pays, Maximum out of pockets expenses, etc.) that will be offered. The plan design(s) proposed by staff shall be in accordance with this motion and shall be evaluated by Mercer in order to assure that the cost to the system is expected to be no greater than that assumed in the 2003 actuarial valuation.

10. That the new plan design for the affected retirees shall become effective no later than January 1, 2005.

Comment: Is this date realistic?

11. That the health care plan design and premium share schedule shall be re-evaluated, as outlined above, in conjunction with every second actuarial

valuation, beginning with the valuation for the year ending December 31, 2004.

By:

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William E. Moller
Secretary

Mr. Ryder's Comments

Restoring Full Funding of CRS Pension Obligations

With Retirees, Active Members and Employers All Contributing While Reducing The Employer Contribution From 23% Of Payroll

1. Coordinate CRS drug coverage with medicare prescription drug coverage so as to maximize savings to the CRS.

2. Decrease CRS expenses by $2,000,000 by reducing active management fees and containing other costs.

3. Reduce medical funding to 85%.

4. Employers each contribute an increased percentage of wages, the same percentage for employers as employees agree to.

5. Have current retirees pay same health care premiums as active AFSCME employees, while limiting retiree share to retiree's COLA.

6. Deductibles and co-pays for current retirees to be unchanged.

7. Redesign retiree health care coverage to encourage retirees to live healthy lifestyles, be more cost sensitive as medical consumers, and give their dependents incentives to decline CRS health care coverage.

8. Persons retiring after 7/1/2005 would receive the same health care coverage as active AFSCME employees.

9. Reduce assumed rate of investment return to 8.5%.

10. Restate actuarial value of CRS asset to market value as of December 31, 2003.